

MOODY'S ASSIGNS AA3 RATING AND A1 RATING TO THE CITY AND COUNTY OF HONOLULU'S WASTEWATER SYSTEM REVENUE BONDS, SENIOR LIEN AND JUNIOR LIEN, RESPECTIVELY.

\$52.2 MILLION DEBT AFFECTED (SENIOR LIEN); \$262.5 MILLION DEBT AFFECTED (JUNIOR LIEN)

Honolulu (City & County of) HI
Utilities
Hawaii

Moody's Rating

Issue	Rating
Wastewater System Revenue Bonds, Senior Lien, Series 1998	Aa3
Sale Amount	\$52,195,000.00
Expected Sale Date	12/09/98
Rating Description	Wastewater System Revenue Bonds, Senior Lien
Wastewater System Revenue Bonds, Junior Lien, Series 1998	A1
Sale Amount	\$262,496,634.00
Expected Sale Date	12/09/98
Rating Description	Wastewater System Revenue Bonds, Junior Lien

NEW YORK, December 4, 1998 -- Moody's has assigned an Aa3 rating to the City and County of Honolulu's Wastewater System Senior Lien Revenue Bonds and an A1 rating to Wastewater System Junior Lien Revenue Bonds. The rating assignments are based on favorable coverage of debt service requirements provided by existing revenues, the projection of manageable rate increases to meet targeted coverage levels, and the fundamentally strong economic base served by the wastewater enterprise. Also noted in the rating assignment are the system's capital plans which will require significant additional borrowings. However, despite these borrowing plans, Moody's expects that the system will successfully achieve the conservative debt and financial operating policies formally adopted by the system's governing board. Honolulu's general obligation bonds are rated Aa2.

EXISTING SYSTEM REVENUES PROVIDE FAVORABLE DEBT SERVICE COVERAGE.

The current offerings are secured by a pledge of net revenues of the wastewater system with existing net revenues providing favorable coverage of peak debt service requirements. Net pledged revenues for fiscal years 1997 and 1998 provide 13.1 and 11.3 times coverage of peak debt service on the senior lien bonds, respectively. Coverage on the combined maximum debt service requirements for both the senior lien and junior lien bonds equals 1.7 times and 1.5 times, respectively, for these years. The long-term projections provided by system management illustrate that coverage levels will remain satisfactory at more than 2 times and 1.5 times on the senior and junior lien bonds, respectively, over the next ten years.

SYSTEM SERVES LARGE, DIVERSIFIED AND PRIMARILY RESIDENTIAL CUSTOMER BASE.

The system provides wastewater services for Oahu with approximately 70% of the island's 840,000 population being served by the system. The customer base is diversified with residential users representing more than 70% of the system's revenues while the ten largest customers account for less than 3% of the flow. A number of small private wastewater systems also serve some areas of Honolulu with a combined average volume of 4.1 million gallons per day (MGD) compared to the Honolulu system which handles an average of 114.8 MGD. The system operates eight wastewater treatment plants serving an area of approximately 500 square miles. The design capacity of existing facilities equals 144.2 MGD while the projected flow in 2020 is expected to equal 148.9 MGD. The system currently provides secondary treatment for 28% of the wastewater flow while the remainder is treated only to the primary level. While sewer service rates are relatively high, at \$404 annually for typical residential customers, it is noteworthy that combined water and sewer rates are more comparable to the bills of urban systems on the mainland. Future rates are projected to increase by 3% annually in fiscal years 2000 and 2001, 3.8% annually in 2002 and 2003, 4.6% annually in 2004 and 2005, and 5.4% annually in 2006 and 2007.

SUBSTANTIAL CAPITAL IMPROVEMENT PLANS TO ADDRESS REGULATORY CONCERNS.

Since 1991, the Environmental Protection Agency, the State of Hawaii, and several environmental groups have filed various legal and regulatory actions against the City and County of Honolulu alleging violations of the federal Clean Water Act and several of the permits held by the wastewater department. Honolulu has entered into four consent decrees, in connection with the settlement of these actions, which establish a required compliance schedule for project implementation. The consent decrees require Honolulu, among other things, to rehabilitate and expand certain existing facilities and to construct new facilities. In addition to actions taken to date, the wastewater department has developed capital improvement plans covering periods of five, ten and twenty years, in part, to comply with the existing consent decrees.

The system's twenty-year capital improvement program identifies approximately \$1.7 billion in projects. Beyond addressing the consent decrees, the long-range capital program will also meet safety and public health, permit compliance, system expansion and reliability issues. Management reports that of the overall program approximately 25% of the projects represent discretionary projects. Capital expenditures over the next five-year period are estimated to equal \$340 million which will be directed to the collection system (65%), treatment plants (25%) and reclamation projects (10%). The capital program will be financed from the proceeds of senior lien bond offerings and will include a pay-as-you-go component expected to equal approximately 15% annually which will be derived from excess net revenues and wastewater system facility charges (which are not pledged to bond repayment). Future senior lien bond offerings are anticipated to equal \$30 million in fiscal 2000, \$50 million in fiscal 2001 and \$85 million in both fiscal 2002 and 2003.

EVOLVING STATE AND FEDERAL REGULATIONS CREATES LEVEL OF UNCERTAINTY REGARDING CAPITAL PLANS.

As with other wastewater treatment systems, the City and County of Honolulu faces evolving state and federal regulations on treatment and discharge standards. The potential for stricter standards in the future adds a measure of uncertainty to the system's future capital needs and additional borrowing plans beyond those currently contemplated by management. However, Moody's believes that the phased aspects of the system's twenty-year capital improvement program will provide management with a fair degree of flexibility to address potential future changes in regulatory requirements.

CURRENT OFFERINGS WILL FUND INITIAL PHASE OF CAPITAL PROGRAM AND REFUND REIMBURSABLE GENERAL OBLIGATION BONDS.

The proceeds of the senior lien bond offering will finance a portion of the five-year capital improvement program. The proceeds of the junior lien bond offering will be applied to refund approximately \$217.8 million of general obligation bonds issued by the City and County for wastewater system purposes. The refunding will allow Honolulu to achieve a more level debt service profile and more closely match the term of its debt with the useful life of the wastewater facilities financed from such debt. The refunding will also achieve a more palatable rate increase pattern for customers. While the extension of existing debt service is not a favorable debt management practice, Moody's believes this restructuring is appropriate given the aforementioned benefits along with management's desire to establish the wastewater system as a self-supporting enterprise operated without property tax support. The refunding will retire the majority of the outstanding wastewater general obligation debt with approximately \$125 million principal amount of bonds continuing to remain outstanding. This outstanding balance is expected to be further reduced through the application of \$20 million of the operating and maintenance reserve in the current fiscal year. The debt service on the general obligation bonds is paid from monies from the city's General Fund which, pursuant to state law, can be reimbursed from net system revenues. The reimbursable general obligation bonds, as well as the debt service on the system's state revolving fund loans, are secured by a lien on net system revenues which is subordinate to the lien created by the junior lien bonds.

FAIRLY STANDARD LEGAL PROVISIONS BOLSTERED BY ADOPTION OF FORMAL FINANCIAL POLICIES BY GOVERNING BOARD.

Legal provisions include covenants to maintain a Debt Service Reserve Fund, equal to maximum annual debt service requirements, on both liens of bonds and stipulate the maintenance of rates and charges sufficient to generate net revenues at least equal to 1.20 times the amount needed to pay debt service on the senior lien bonds and 1.10 times on combined senior and junior lien debt service. A similar covenant is provided for the issuance of additional parity bonds under both liens although officials report that all future borrowings will be issued through the senior lien.

The bond covenant provisions are significantly bolstered by the formal adoption of conservative debt and financial operating policies by the city council which require compliance with annual targets of 1.6 times coverage on the senior lien bonds and 1.25 times on all bonds. In addition, the city council resolution incorporates a favorable three month operating and maintenance reserve fund policy which will serve to insulate the system from unexpected events. Moody's expects that the system will comply with these more stringent operating policies as opposed to the levels stipulated by the legal covenants of the bond documents.

OUTLOOK:

A stable rating outlook is based on the expectation that, despite the presence of significant future borrowing plans, the system will maintain the conservative financial and debt policies stipulated by city council resolution. Furthermore, Moody's expects that future debt issuance will be managed prudently to ensure the continuation of debt measures which are comparable with other highly-rated enterprise systems.

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